The New Ohio Professional Associations Act and the Preclusion of Corporations from the Practice of Law

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THE NEW OHIO PROFESSIONAL ASSOCIATIONS ACT
AND THE PRECLUSION OF CORPORATIONS
FROM THE PRACTICE OF LAW

State ex rel. Green v. Brown
173 Ohio St. 114, 180 N.E.2d 157 (1962)

The relator, a practicing attorney, attempted to file articles of incorporation pursuant to the new Ohio Professional Associations Act to form two corporations for the purpose of engaging in the practice of law. The respondent, the secretary of state of Ohio, refused to accept the articles for filing, and the relator brought this action in mandamus to compel such acceptance. The respondent demurred to the petition, and the demurrer was sustained in the instant decision. The supreme court held that only it had the power to admit persons to the practice of law; that, under Rule XIV of its Rules of Practice, the right to practice law was limited to natural persons; and that, therefore, the secretary of state was not under any clear duty to accept for filing the articles of a corporation which proposed to practice law.

In almost every state of the union the power to grant admission to the practice of law is conceded to belong exclusively to the judicial branch of government. In almost every state of the union the power to grant admission to the practice of law is conceded to belong exclusively to the judicial branch of government. Although in some states this power is granted to the courts by the state constitution, the Ohio constitution contains no such provision. How-

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4 Mahoning County Bar Ass'n v. Franko, 168 Ohio St. 17, 151 N.E.2d 17 (1958); In re McBride, 164 Ohio St. 419, 132 N.E.2d 113 (1956); Judd v. City Trust & Sav. Bank, 133 Ohio St. 81, 12 N.E.2d 288 (1937); Dworken v. Apartment House Owners' Ass'n, 28 Ohio N.P. (n.s.) 115 (C.P. 1930), aff'd, 38 Ohio App. 265, 176 N.E. 577 (1931); In re Thatcher, 12 Ohio N.P. (n.s.) 273, 22 Ohio Dec. 116 (C.P. 1912).

5 As noted in Columbia University Drafting Research Fund's, Index Digest of State Constitutions 42 (2d ed. 1959), power over admission to the bar is clearly granted to the judiciary in the constitutions of Arkansas (amend. 28), Florida (art. V, §§ 23, 26), and New Jersey (art. VI, § II, ¶ 3). In addition, the power may be implied in the "power of disbarment" which is granted to the judicial branch of government by the constitution of Louisiana (art. VII, § 10).
ever, the Ohio courts have held that the power is inherent in their composition as courts.\(^6\)

The General Assembly has, by statute, conceded that the power over admission to the bar belongs to the supreme court.\(^7\) The legislative authority in this sphere of activity has been limited to the enactment of statutes providing standards or procedures which will aid but not restrict the courts in the performance of this function.\(^8\) Legislation which attempts to usurp the function is invalid.\(^9\)

Several Ohio decisions have held that a corporation\(^10\) may not engage in the practice of law.\(^11\) However, only one of these cases, a common pleas court decision, declared that any attempt by the legislature to sanction "or even hint at the propriety of" the practice of law by a corporation would be invalid, and this declaration was made as obiter dicta.\(^12\) It should be noted that the authority cited by the court for this proposition was a case involving a statute which purported to reinstate a specific, disbarred attorney; it did not involve corporations, nor did it involve general laws providing procedures for incorporation by attorneys.\(^12\) All of the other Ohio cases holding that corporations could not practice law have remained silent on the question of whether the disability was absolute or merely resultant from the then existing state of the law and rules of court. Furthermore, all of these decisions were rendered at a time when the issue was controlled by section 1701.03 of the Ohio Revised Code, prior to the adoption of the Professional Associations Act. Section 1701.03 provides that "A corporation may be formed for any purpose of purposes, other than for carrying on the practice of any profession. . . ." Therefore, it appears that none of these courts was faced with the

\(^{6}\) Mahoning County Bar Ass'n v. Franko, supra note 4; In re McBride, supra note 4; Judd v. City Trust & Sav. Bank, supra note 4; In re Thatcher, 80 Ohio St. 492, 655, 89 N.E. 39, 84 (1909).

\(^{7}\) Ohio Rev. Code § 4705.01 (1953) provides in part: "No person shall be permitted to practice as an attorney . . . unless he has been admitted to the bar by order of the supreme court. . . ."

\(^{8}\) In re McBride, supra note 4; In re Thatcher, supra note 4.

\(^{9}\) State ex rel. Thatcher v. Brough, 15 Ohio C.C.R. (n.s.) 97, 23 Ohio C.C. Dec. 257 (1912); In re Thatcher, supra note 4.

\(^{10}\) Dunkel, "Professional Corporations," 22 Ohio St. L.J. 703, 705-706 (1961), points out that although the title of the act in question refers to "Professional Associations," it does not create a new form of business organization, but merely extends chapter 1701 of the Revised Code, the general corporation law, to encompass professions. Thus, the entity which is permitted is, in fact, a corporation.


\(^{12}\) Steer and Adair v. Land Title Guar. & Trust Co., supra note 11, at 40, 113 N.E.2d at 767.

\(^{13}\) State ex rel. Thatcher v. Brough, supra note 9.
question of whether a corporation should be allowed to practice law if the statutes governing corporations permitted such practice.

The importance of this distinction results from the fact that the problem here considered actually involves two phases. Under the Ohio constitution, the legislature is prohibited from exercising judicial functions; and, as has previously been shown, the admission of attorneys to the practice of law is a function of the judiciary. However, the constitution expressly grants authority to the General Assembly to enact and amend the General Corporation Law. Thus, the situation is one in which, to permit the practice of law through a corporate form, two agencies must act: the legislature must permit lawyers, as professional persons, to incorporate, and the supreme court must permit the corporations thus formed to practice. As the Florida Supreme Court noted in its recent decision permitting the lawyers of that state to practice in a corporate form, the legislative sanction is of no advantage to the attorneys without the enabling action of the court. The new Ohio Professional Associations Act grants this legislative sanction to attorneys to form corporations. The effect of the decision in the instant case is to withhold the court's enabling action.

Since the statutory bar to incorporation by lawyers which was formerly imposed by section 1701.03 of the Ohio Revised Code has now been removed by the enactment of the Professional Associations Act, the question remaining is whether and under what conditions the Ohio Supreme Court should permit legal professional associations to practice law. To answer this question, consideration must first be given to the factors which earlier decisions have listed as the reasons why a corporation should not be allowed to practice law.

First, there is the argument that a practicing attorney must meet the moral and educational standards prescribed by the court and that a corporation is obviously incapable of doing so. This argument seems to carry the fiction of the corporate entity too far. Although it is common to speak as if the corporation itself were practicing law, it can only do so in the vicarious sense that the acts of its agents will be imputed to it. The actual performance of every act attributed to the corporation must be effectuated by one of its agents. The Professional Associations Act would insure that only those agents who had met the court's moral and educational requirements would be allowed to practice for the corporation. Therefore, this argument does not seem to be meritorious in the present circumstances.

Secondly, arguments have been put forth that the practice of law by corporations would lead to the "exploitation" of "captive lawyers" in order to sell their work product at a "merchant's profit" and the destruction of

\[14\] Ohio Const. art. II, § 32.
\[15\] Ohio Const. art. XIII, § 2; Belden v. Union Cent. Life Ins. Co., 143 Ohio St. 329, 55 N.E.2d 629 (1944).
\[16\] In the Matter of The Florida Bar, 133 So. 2d 554, 555 (Fla. 1961).
\[19\] Steer and Adair v. Land Title Guar. & Trust Co., supra note 11, at 39, 41, 113 N.E.2d at 766, 767.
the "personal relationship" which should exist between the lawyer and his client.\footnote{Land Title Abstract & Trust Co. v. Dworken, supra note 11, at 30-31, 193 N.E. at 653; Marshall v. New Inventors' Inc., supra note 11.} The choice of language used in these arguments indicates that, to some extent, they are based upon emotion. When the emotion is brushed away and conditions are examined rationally, the arguments lose their force. It is common for large law partnerships to employ many lawyers to perform the work of the partnership, and yet the courts have not found that such partnerships are engaging in the "exploitation" of "captive lawyers" for a "merchant's profit" or destroying the "personal relationship" between lawyer and client. There is no reason why these evils should be more likely to exist in a professional association owned and managed by lawyers than in a large law partnership. The differences in organizational form between a professional association and a partnership are not among the potential causes of such injustices. Although the courts must be alert to prevent these practices, proscribing the formation of professional associations by attorneys will not promote this end.

The third argument which has been used by the Ohio courts is that a lawyer employed by a corporation would owe his primary duty of fealty to his employer rather than to his client.\footnote{Judd v. City Trust & Sav. Bank, supra note 4, at 87, 12 N.E.2d at 291; Land Title Abstract & Trust Co. v. Dworken, supra note 11, at 30-31, 193 N.E. at 653.} This argument is partially answered by the considerations previously noted; it cannot be relevantly directed only against professional associations since it applies with equal force against large law partnerships. However, there is an additional aspect of this argument which is indicated by the fact that both of the Ohio cases which have relied upon it were dealing with nonprofessional, commercial corporations.\footnote{Ibid.} It is true that, if the lawyer's services are managed and sold by a lay organization, the lawyer may not be able, consistently with his duty to his employer, to fulfill the professional obligations imposed upon him by the Canons of Legal Ethics. However, if the controlling agents of the employer are themselves trained in the traditions of the legal profession and subject to the control of the Canons, this danger will be avoided.\footnote{American Bar Association Committee on Professional Ethics, Opinion 303, 48 A.B.A.J. 159, 160-61 (1962).} Therefore, although this argument does not provide a sound reason for absolutely prohibiting the practice of law by professional associations, it does illustrate that, if such practice is to be permitted, the Professional Associations Act must be supplemented by provisions in the Rules of Practice requiring that the control of the professional activities of the firm be vested exclusively in authorized attorneys.\footnote{For examples of such rules adopted by the courts of other states when permitting lawyers to practice through forms similar to professional associations, see In the Matter of the Florida Bar, supra note 16, at 557-558; Colo. Sup. Ct. R. re Professional Service Corporations (Dec. 5, 1961).}
tice of law by a corporation. These potential conflicts have been examined by the Committee on Professional Ethics of the American Bar Association. The Committee noted that the characteristics of professional associations are: (1) limited liability; (2) centralized management; (3) continuity of life; and (4) free transferability of interests. The Committee ruled that attorneys might ethically practice under a form of organization which possessed these characteristics if certain restrictions were observed. First, the personal liability of the individual lawyer rendering the services must be maintained, and the restrictions on the liability of the other members of the firm must be made apparent to the client through the use of a firm name indicating the fact of incorporation. Second, the central management of the corporation must be positively restricted to attorneys. Third, the transfer of permanent beneficial voting interests must be restricted to members of the legal profession. In addition, further restrictions must be imposed so that, in the event that the death, bankruptcy, or incapacitation of a shareholder requires that his shares come into the hands of a lay administrator, the administrator will be prohibited from having access to confidential communications, taking part in the management of the corporation, sharing in fees earned during his administration, or holding the shares for an undue length of time before reconveying them to an authorized attorney or to the corporation. Fourth, although the corporation may pay salaries to its nonprofessional employees, such salaries

25 American Bar Association Committee on Professional Ethics, Opinion 303, supra note 23.

26 Id. at 160.

27 Ibid. The requirement that the firm name reflect the limited character of the liability is contained in section 1701.04(A)(1) of the Revised Code, which is applicable to professional associations through the carry-over provisions of Ohio Rev. Code § 1785.08. The requirement that the individual practitioner remain liable for his own acts is apparently satisfied by Ohio Rev. Code § 1785.04; however, see text accompanying notes 40 and 41 infra.

28 American Bar Association Committee on Professional Ethics, Opinion 303, supra note 23, at 160-161. Enforcement of this restriction would require supplementing the Professional Associations Act with an amendment to the Rules of Practice such as those referred to note 24 infra.

29 American Bar Association Committee on Professional Ethics, Opinion 303, supra note 23, at 161-162. This restriction is already embodied in the Professional Associations Act. Ohio Rev. Code §§ 1785.05, 1785.07.

30 American Bar Association Committee on Professional Ethics, Opinion 303, supra note 23, at 162. The enforcement of these variegated requirements may be attended by some difficulty. If the supreme court should permit professional associations to practice law, it might solve the enforcement problem by amending the rules of practice to prescribe that these individual requirements be written into each association's articles or, perhaps, into the express terms of its shares. However, this might lead to some complicated situations where compliance as well as surveillance would be difficult. A simpler and more certain solution might be found in an amendment requiring the articles of a legal professional association to provide for the immediate resale to and repurchase by the association of the shares of any member who died, went into bankruptcy, or suffered some other incapacitation requiring the appointment of an administrator.
must not be based upon a percentage of the profits earned by the corporation.31

In analyzing the feasibility and desirability of changing the Rules of Practice to permit the practice of law by professional associations, it should be pointed out that the primary purpose of those who advocate the change is to secure for attorneys the tax advantages which the federal government has extended to corporations. The principal tax benefit sought is the right of a corporation to deduct amounts paid into pension trusts or group insurance plans for the benefit of employees, while the tax, if any, paid by the employees is deferred until the time of receipt of the benefits, which will be after the employee’s peak income years in higher tax brackets are past. A second and related advantage is the right of the employees or their beneficiaries to receive sick pay or death benefits from the employer without treating them as taxable income.32 However, it is by no means certain that professional associations will qualify for these tax benefits. The Internal Revenue Service has ruled that a pension trust may not be used as a “subterfuge for the distribution of profits to shareholders.”33 Another income tax regulation provides that an unincorporated organization, if it is to be treated as a corporation for tax purposes, must possess at least three of the four following characteristics: (1) continuity of life; (2) centralization of management; (3) liability for corporate debts limited to corporate property; and (4) free transferability of interests.34 Although a professional association is not an “unincorporated organization,” it seems likely that such associations will be required to meet similar requirements for tax purposes. As will be indicated later, it would probably be impossible for a legal professional association to meet these standards. When this is considered, it becomes important that one observer believes that the Commissioner of Internal Revenue may challenge the use of professional associations as a tax-reducing device.35

Furthermore, a secondary consequence of sanctioning the practice of law by legal professional associations, although probably not a purpose of those advocating a change in the Rules of Practice, might be a deviation from the established law of professional liability. Traditionally, an individual lawyer has always been liable both upon his contracts36 and for his torts,37 and all of the members of a partnership have been jointly liable upon the contracts38

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31 American Bar Association Committee on Professional Ethics, Opinion 303, supra note 23, at 161. Enforcement of this restriction would require supplementing the Professional Associations Act with an amendment to the Rules of Practice forbidding attorneys who practice through professional associations from paying their employees such contingent salaries.
32 In the Matter of The Florida Bar, supra note 16, at 555; Dunkel, supra note 10, at 703-704.
34 Treas. Reg. § 301.7701-2(a)(3) (1960); Dunkel, supra note 10, at 705.
35 Dunkel, supra note 10, at 711.
36 Weekley v. Knight, 116 Fla. 721, 156 So. 625 (1934).
37 Lawall v. Groman, 180 Pa. 532, 37 Atl. 98 (1897).
and jointly and severally liable for the torts\textsuperscript{39} attributable to any one of the partners while acting for the firm. This of course means that every lawyer must bear the risk not only of his own conduct but also of any lack of diligence or probity on the part of any partner he may have. Section 1785.04 of the Ohio Professional Associations Act provides that the act shall not "modify any law applicable to the relationship between a person furnishing professional service and a person receiving such service, including liability arising out of such professional service." This statute presents problems of vagueness in certain respects; for instance, does the term "person furnishing professional service" include an entity such as a partnership or a professional association. However, the statute is an important part of the Professional Associations Act insofar as lawyers are concerned since, as has previously been noted,\textsuperscript{40} the Committee on Professional Ethics of the American Bar Association has ruled that for the practice of law through a corporate form to meet the requirements of the Canons of Legal Ethics, the personal liability of the individual lawyer rendering the services must be maintained.

However, if it is true that a professional association is a form of corporation,\textsuperscript{41} then the authority of the General Assembly to create such an entity must be determined in light of article XIII of the Ohio constitution, which governs the enactment and amendment of the General Corporation Law. Section 3 of article XIII provides that "in no case shall any stockholder be individually liable otherwise than for the unpaid stock owned by him or her." Section 1785.04 of the Revised Code would impart a quality to professional associations precisely contrary to that prescribed for corporations by this constitutional provision. Rather than limiting the liability of a lawyer-stockholder to the unpaid price of his stock, it would maintain his individual liability upon his contracts as well as his torts, and might also be construed to preserve the liability of all members of a firm for the agreements or acts of any one of their number. Therefore, if a professional association is a form of corporation, section 1785.04 of the Professional Associations Act must be partially unconstitutional and void. Consequently, an individual member of a professional association would not be personally liable upon a contract which he entered into on behalf of the firm. This immunity might violate the aforementioned ethical requirement that the personal liability of the individual lawyer rendering the services for the professional association must be maintained. Moreover, even if this immunity from contractual liability would not breach ethical requirements, a further result would be that all members of a law firm adopting the form of a professional association would be relieved of personal liability except for unpaid stock and their own tortious conduct. Whether this abrogation of personal liability for the acts of fellow firm members would have any deleterious effect on the maintenance of professional ethics is a question of policy too broad to be fully discussed here. However, it is arguable that the imposition of personal liability upon lawyers for the malpractice of their co-workers prevents such malpractice by impelling scru-

\textsuperscript{40} See text accompanying note 27 supra.
\textsuperscript{41} See note 10 supra.
pulous practitioners to use care in the selection and observation of their associates. Furthermore, the curtailment of this personal liability would greatly reduce the protection which the law has traditionally granted to the clients of attorneys. These considerations must be taken into account by the supreme court if it should be asked to alter the Rules of Practice in order to permit attorneys to do business through the form of professional associations.

Even if professional associations are not "corporations" subject to the provisions of section 3 of article XIII of the Ohio constitution, and section 1785.04 of the Professional Associations Act is therefore valid, the fact remains that, in order to secure the tax benefits conferred upon corporations, a professional association may be required to have the characteristic either of freely transferable interests or else of limited liability. As has been pointed out, the beneficial voting interests in a legal professional association could not be freely transferable; sections 1785.05 and 1785.07 of the Professional Associations Act restrict the issuance and transfer of shares to licensed practitioners, and the Canons of Legal Ethics would impose further restrictions in the event of the death, bankruptcy or incapacitation of a shareholder. Therefore, if professional associations were to meet the criteria of such tax regulations, they would not be entitled to corporate tax privileges unless they possessed the characteristic of limited liability. If section 1785.04 of the Professional Associations Act is not unconstitutional and does effectively maintain the traditional responsibility of the individual practitioner in a professional association for his own contracts and torts, or perhaps even the traditional liability of the other firm members, legal professional associations would not qualify for the desired tax treatment. The proponents of authorization for such associations would thus be trapped in a dilemma: the organizational form which they are advocating could be made to satisfy the ethical requirements of the Canons or it could be made to qualify for corporate tax benefits, but it would not be possible to make it do both.

To recapitulate, although the practice of law through a modified corporate form would not be inherently improper, the limited-liability provision of section 3 of article XIII of the Ohio constitution poses a serious question as to the propriety of the practice of law through the form of professional associations in this state. Furthermore, even if the Ohio Professional Associations Act were held not to be affected by this constitutional provision, such practice will not be permissible until authorized by the supreme court. A prerequisite to such authorization would be a thorough and careful amending of the Rules of Practice. However, after these necessary amendments were made, it seems doubtful that legal professional associations would qualify for the tax advantages which the advocates of authorization wish to receive. In view of these considerations, it seems fairly clear that the wisest course would be to continue to preclude attorneys from practicing through a corporate form, at least until there has been opportunity to observe results in those states which have permitted professional associations to practice law.

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43 See text accompanying note 30 supra.